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WASHINGTON D.C. 20548

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The Honorable Joseph P. Addabbo
Chairman, Subcommittee on Defense
Committee on Appropriations
House of Representatives

Dear Mr. Chairman:

This letter responds to your recent request for further comments on the scope of language in the Supplemental Appropriations and Rescission Act of 1981 that limits the type of commercial insurance for which the Navy may reimburse shipbuilders. 1/ We discussed our interpretation of the general scope of the provision in a letter to you dated July 22, 1981. You have now asked us to expand our analysis based on additional material your staff provided us.

In our first letter, we discussed the effect of the distinction in the law between casualty or fortuitous losses caused by defective workmanship or materials, and losses incident to the normal course of construction, such as the cost of repairing or replacing defective workmanship or materials, but which do not involve casualties or fortuitous events. As we noted in our July 22 letter, the scope of commercial insurance coverage available to shipbuilders is significant to determining the practical

1/ The Act provides in pertinent part:

"None of the funds appropriated to the Department of Defense for fiscal year 1981 and hereafter shall be available for obligation to reimburse a contractor for the cost of commercial insurance (other than insurance normally maintained by the contractor in connection with the general conduct of his business) that would protect against the costs of the contractor for correction of the contractor's own defects in materials or workmanship incident to the normal course of construction (those defects in materials or workmanship which do not constitute a fortuitous or casualty loss)." Pub. L. No. 97-12, 95 Stat. 14, 29-30.

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impact of the Act's prohibition. Your staff then provided us with copies of letters, one from a shipbuilder and one from a shipbuilder's trade association, discussing the scope of commercial shipbuilders insurance.

The Act now prohibits reimbursement of premiums for insurance covering shipbuilders' losses that are incident to the normal course of construction and are caused by the shipbuilders' own defective workmanship or materials, not resulting in casualty or fortuitous losses. The letters from the shipbuilding industry contend that the standard commercial shipbuilders insurance policy does not cover those types of losses. ^{2/} Conversely, the Act does not prohibit reimbursement for commercial insurance covering casualty or fortuitous losses caused by defective workmanship or materials. According to the industry sources, standard shipbuilders insurance does cover casualty or fortuitous losses, regardless of whether they result from the shipbuilder's defective workmanship or materials or some other cause.

Assuming that the shipbuilders' description of the standard shipbuilders' policy is accurate, the impact of the Act's prohibition on a shipbuilder whose coverage takes the form of the standard policy is limited, since the Act in effect allows reimbursement for standard shipbuilders' coverage, and prohibits reimbursement only for coverage not included as part of the standard shipbuilders' policy.

You also asked us to draft language amending the Act to prohibit reimbursement for the cost of commercial insurance covering casualty losses resulting from defective workmanship or materials. One step toward accomplishing this would be to delete the final qualifying phrase--"(those defects in materials or workmanship which do not constitute a fortuitous or casualty loss)"--from the current provision.

^{2/} According to a memorandum by the Committee's Surveys and Investigations Staff, the shipbuilders' position on the scope of standard coverage has varied over the years. Between 1942, when the Navy first assumed the risks for which shipbuilders previously had procured commercial insurance coverage, and 1980, the shipbuilders agreed that standard coverage precludes recovery for routine defects in workmanship or materials not resulting in a casualty or a fortuitous event. In 1980, the Electric Boat Division of General Dynamics, joined by other shipbuilders, rejected that position in the course of the dispute with the Navy which was the impetus for passage of the prohibition in Public Law 97-12. The current letters from the shipbuilders indicate a return to their pre-1980 position that defective workmanship, without more, is not covered under the standard policy.

However, as we noted in our July 22 letter, it is possible that other language included parenthetically in the current provision--"(other than insurance normally maintained by the contractor in connection with the general conduct of his business)"-- would allow reimbursement to shipbuilders in certain circumstances. That is, if a shipbuilder showed that he normally carried insurance covering the cost of curing defective performance, the provision would not prohibit reimbursing him for the cost of that insurance. Accordingly, deleting the above-quoted phrase also would more likely ensure that reimbursement could not be made under any circumstances. Finally, the wording must be changed to make clear that the provision applies not only to the costs of correcting defects in materials or workmanship, but also to the costs of casualties or fortuitous events resulting from or caused by defects in materials or workmanship. This version would thus read:

"None of the funds appropriated to the Department of Defense for fiscal year [1981] and hereafter shall be available for obligation to reimburse a contractor for the cost of commercial insurance that would protect against the costs of the contractor for correction of the contractor's own defects in materials or workmanship or against the costs of fortuitous or casualty losses resulting from such defects."

We trust this adequately responds to your request.

Sincerely yours,

MILTON J. SOCOLAR

For Comptroller General
of the United States

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DIGEST

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Letter replying to request by Representative Joseph P. Addabbo for further comments on provision in Supplemental Appropriations and Rescission Act limiting types of commercial insurance for which Department of Defense contractors may be reimbursed. Letter concludes that provision does not prohibit reimbursement for most common type of commercial shipbuilders insurance, covering casualty losses caused by defective performance. Letter also proposes draft legislative language to prohibit reimbursement for commercial insurance covering losses from shipbuilder's defective performance.